READ AND STUDY PORTFOLIO 1

How the government attempts to reduce inequality in society through social and fiscal measures

In the first part, we concluded that income (and wealth) is unevenly distributed in the economy. There are various explanations for this inequality, which can be measured.

In the second part, we will focus on how this inequality can be reduced. We will ask ourselves the following questions:

1. Why reduce inequality?
2. What instruments does the government have to reduce inequality?
3. To what extent is this redistribution policy effective?

1. Why reduce inequality?

There are five good reasons why economic inequality must be reduced.

1. Social justice

Significant income inequality can be seen as unjust, especially when it arises from circumstances over which people have little control (for example, the factors we have discussed: social factors, random factors).

Redistribution makes society fairer and gives people from disadvantaged backgrounds opportunities.

2. Social stability and cohesion

Extreme inequality can lead to tensions, distrust in institutions and even social unrest. If income inequality becomes too great, it can lead to an unbalanced distribution of power (the richest gain too much influence over politics and policy).

Example:

In Scandinavian countries (such as Sweden, Norway, Denmark and Finland), income inequality is relatively low due to strong government redistribution policies (see below). As a result, citizens feel that the government redistributes wealth fairly and effectively, enabling most people to enjoy a good standard of living and equal opportunities. This reduces social tensions and increases the sense of justice.

A more balanced distribution therefore strengthens society and also reinforces trust between citizens and government. Limiting inequality prevents economic power from translating into political dominance.

3. Economic efficiency

Inequality can slow down economic growth: people on low incomes often have less access to good education, healthcare or training opportunities, which means that talent remains untapped.

By investing in redistribution and equal opportunities, the government can stimulate economic growth. What's more, people with higher incomes also pay more social security contributions and taxes, which is good for public finances.

4. Reducing poverty

Inequality and poverty are closely linked: if incomes are distributed too unevenly, part of the population ends up below the poverty line.

By redistributing income, the government can guarantee basic needs (housing, food, healthcare) for more people.

Example:

In China, the government identifies 'poor regions' and sets up specific projects there (such as infrastructure, education, healthcare). The government also implements a programme of 'targeted poverty reduction', in which families receive individual support in securing their basic needs.

5. Health and well-being

Research shows that societies with less inequality are healthier, have lower crime rates and higher life expectancies.

Equality therefore contributes to the general well-being of the population.

2. What instruments does the government have to reduce inequality?

You can distinguish between measures taken BEFORE and AFTER people enter the labour market and earn a (lower or higher) income.

BEFORE

The role of compulsory education:

By making education compulsory for children, their basic level of knowledge and skills increases. This improves their chances of finding better and better-paid jobs. Children from low-income families are given more opportunities to climb the social and economic ladder. This reduces inequality between generations. Education offers a minimum guarantee that everyone will develop basic skills, thereby reducing differences in opportunities.

Example:

For decades, Finland has invested heavily in a uniform and compulsory education system. Education is completely free (including university), including meals, books and often transport. There are hardly any private schools; virtually everyone receives the same high-quality public education. Extra support is given to pupils who fall behind, so that differences do not widen. Thanks to the high quality and accessibility of education, children, regardless of their background, have equal opportunities to obtain a good job and a stable income.

The role of integration programmes (for foreign-language newcomers)

Language is crucial for finding work and actively participating in society. Language education reduces disadvantages in the labour market. Integration programmes give newcomers insight into rules, rights and obligations, enabling them to participate more quickly in social and economic life. This reduces the gap between groups.

Example:

Canada is often cited as an example of successful integration of foreign-language newcomers. This is due to an active integration policy that focuses not only on language, but also on participation. This is achieved through language support, free English or French language courses for newcomers, focusing on both general language skills and practical skills (e.g. applying for jobs, filling in forms). But also through programmes that help newcomers get their qualifications recognised. Training and internships are provided to help them find work more quickly. Finally, integration programmes explain how Canadian society works (rights, obligations, values). This increases understanding and social cohesion, enabling newcomers to become part of the community more quickly.

The role of legislation

The government can enact laws and regulations that enforce equal treatment. A sound legal framework has both a preventive and corrective effect. A prime example is anti-discrimination legislation, which prohibits discrimination on the basis of origin, gender, religion, disability, sexual orientation, etc. This protects citizens against exclusion in the labour market, in education or when looking for housing. The result: everyone has a fairer chance, regardless of their background. A second example is laws that require employers to pay men and women the same for the same work. This reduces gender pay inequality and improves the economic position of women.

Conclusion: these three forms of government intervention create more equal opportunities for people entering the labour market.

AFTER

Once you are active in the labour market and earning an income, there are three other forms of government intervention: taxes, the social security system and quasi-public goods.

Taxes

1. What are income taxes?

Income taxes are taxes that citizens pay on their wages/salaries, income from assets or other sources of income. The more someone earns, the more tax they have to pay. This is an important source of income for the government to finance public services (e.g. education, healthcare, infrastructure).

2. What are progressive taxes?

In a progressive tax system, the tax rate increases as income rises. For example, low incomes pay 25% tax, middle incomes pay 35% and high incomes pay 50%. This means that wealthier citizens contribute proportionally more than poorer citizens.

3. How do progressive taxes redistribute wealth?

They ensure income redistribution: high incomes contribute relatively more, low incomes retain relatively more of their income, thereby narrowing the gap between rich and poor. The additional tax revenues can also be used to combat poverty and increase opportunities (e.g. through subsidies, social housing or free education).

(In a separate exercise bundle, we illustrate this redistributive effect using exercises.)

Social security system

1. What is the social security system?

The social security system is a system of social benefits that protects citizens with a replacement income against loss of income due to circumstances such as illness, unemployment, old age or incapacity for work. On the other hand, the system also provides a supplementary income to cover certain costs such as raising children, going on holiday, etc. It is financed through social contributions (employers and employees) and often also through taxes. Examples of social security benefits are: unemployment benefit, sickness and disability benefit, pension, Groeipakket (child benefit) and holiday pay. The first three examples are replacement incomes, the last two examples are supplementary incomes.

2. How does the social security system redistribute wealth?

The social security system has a redistributive effect through the role of benefits:

REPLACEMENT INCOME

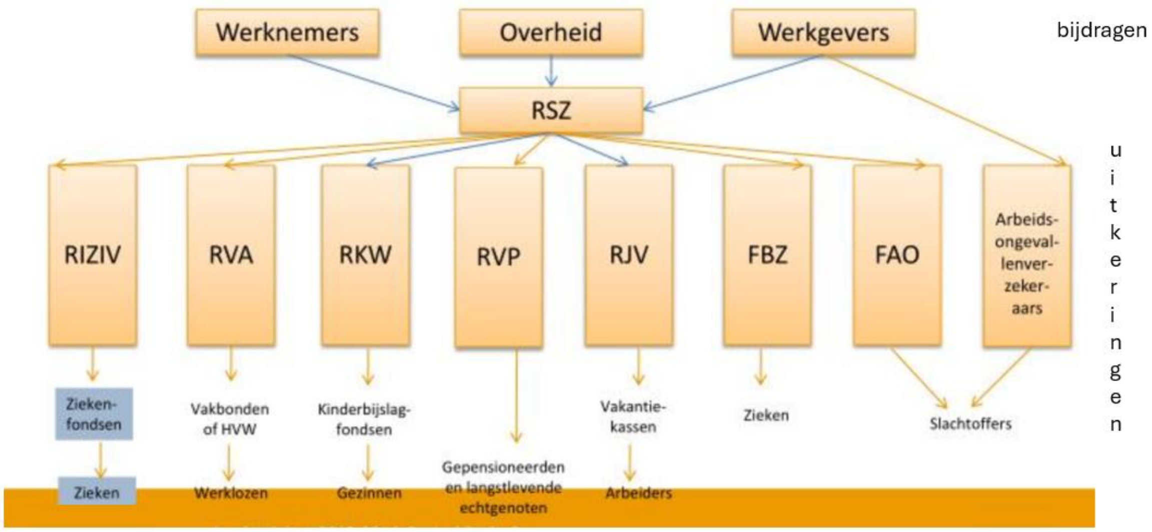
Anyone who becomes unemployed or ill receives benefits so that they are not left without an income.

SUPPLEMENTARY INCOME

Free or affordable healthcare, education and child benefit ensure that families with limited means also have opportunities.

The social security system therefore acts as a safety net. This safety net enables people to recover from difficult situations and keeps income differences within limits. People with higher incomes contribute more through taxes and contributions, while benefits mainly go to people with lower incomes or greater needs.

(Social security system chart in Dutch)



Quasi-public goods

We know from a previous theme what quasi-public goods are.

Let's zoom in on two examples: subsidised education and public transport.

1. Subsidies for education

By financing education (partially or fully), the government makes it accessible to everyone, regardless of income. Students from low-income families thus have the same opportunities to obtain qualifications as young people from wealthy families. Education increases the chances of finding a well-paid job, resulting in greater social mobility and less inequality.

2. Public transport

Cheap or free public transport enables everyone to go to school, work or training. This gives people on low incomes, who cannot afford a car, access to the same opportunities. It also increases labour mobility: people can more easily take a job outside their own neighbourhood.

Both measures reduce structural barriers that perpetuate poverty (lack of access to education or work). By removing barriers, opportunities in society are distributed more evenly, narrowing the gap between rich and poor.

3. To what extent is this redistribution policy effective?

The question is whether the redistribution policy of taxes, social security and quasi-public goods is also 100% effective.

We take a critical look at each of these government instruments on the basis of three phenomena: tax avoidance and tax evasion, the Matthew effect and privatisation.

Tax avoidance and tax evasion

Tax avoidance is the legal use of tax structures and “loopholes” to pay as little tax as possible (e.g. parking money in tax havens). Tax evasion = illegally paying no or too little tax (e.g. concealing income, undeclared income).

These two phenomena weaken the redistributive effect of taxation: wealthy individuals and large companies have the resources to hire expensive accountants, lawyers and tax advisors. Large fortunes can be more easily shifted to tax havens or hidden through complex constructions. Higher incomes more often consist of capital gains (dividends, interest, shares) that are easier to shift or conceal than ordinary wages.

Taxes (especially progressive taxes) are intended to reduce inequality: higher incomes contribute relatively more, enabling redistribution. However, if high incomes and fortunes systematically avoid or evade taxes, they contribute less than anticipated.

Matthew effect

The Matthew effect refers to the biblical principle: 'To those who have, more will be given; to those who have nothing, even what they have will be taken away.' In social security, this means that the benefits of social measures often go to people who are already better off, rather than to the most vulnerable groups.

Some examples:

-Child benefit: all families receive the same amount, including wealthy families who do not really need it.

-Tax deductions/subsidies: tax benefits for e.g. pension savings or housing bonuses are mainly used by higher income groups (they have the money to save or buy a house).

-Healthcare: higher income groups make more use of expensive specialist care or can more easily pay personal contributions.

Consequence: because higher income groups also (and often primarily) benefit from these social measures, the redistributive effect of social security is weakened. The money intended to reduce inequality partly ends up with groups that do not need it or need it less. As a result, the gap between rich and poor remains greater than if the benefits went exclusively to the lowest income groups.

Privatisation

Governments may decide to privatise quasi-public goods, such as public transport (trains), for various reasons.

-Financial reasons: privatisation generates a one-off sum of money for the government (through sale) and reduces management and maintenance costs.

-Efficiency argument: it is assumed that private companies operate more competitively than the government and are therefore more efficient and innovative.

-Ideological reasons: some governments believe that the market is better than the state at organising services (neoliberal vision).

Practice shows that privatisation of public transport, for example, often leads to higher prices. Private companies want to make a profit, whereas a public service was often provided at cost price. They can also discontinue cheaper, less profitable services (e.g. in remote areas). Once the government is no longer the owner, it also has less direct influence on tariffs and service provision.

Consequence: higher prices make it more difficult for low-income households to pay for basic services (energy, transport, healthcare). Wealthy households can continue to afford these services, widening the gap between rich and poor. Quasi-public goods thus lose their role as equalisers in society.

Example from the news following the debate on whether or not to privatise the NMBS:

Much recent research contradicts the notion that public companies are less efficient than private companies. In practice, the efficiency of privatisation often means savings on staff, services and long-term investments and/or higher prices for the customer. At the same time, employees, customers and taxpayers often pay extra for the dividends that shareholders of private companies expect and for the generous remuneration that management in private companies receives. It is therefore not surprising that privatisation is being questioned more and more, and that there even seems to be a trend towards scaling back privatisation.